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GLOBALIZATION REPORT CARDS FOR SECURITIES REGULATORS: NATIONAL ENFORCEMENT OF INTERNATIONAL CAPITAL MARKET STANDARDS FOR INFORMATION SHARING AND COOPERATION AND THE PREVENTION OF FINANCIAL CRISES

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**GLOBALIZATION REPORT CARDS FOR SECURITIES
REGULATORS: NATIONAL ENFORCEMENT OF
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PREVENTION OF FINANCIAL CRISES**

*Andrea M. Corcoran**

I. INTRODUCTION

The 2007–2009 credit crisis and the threatened breakdown of the world's financial system moved gaps in regulation, and the capacity of international cooperation to fill those gaps, to the top of the agenda of global leaders—both politicians and regulators. The rescue of the financial regulatory community from its inability to anticipate, assess, measure, and mitigate, if not prevent, toxic synergies among multinational financial services providers still burdens the public purse in almost every jurisdiction. Indeed, although recovery appears to be on the horizon, the lingering memory of the cost, and the assumed inevitability, of that rescue continues to threaten the economy, the policies, and even the incumbency of presiding policymakers and regulatory institutions.¹

Multiple parties, both national and international, have offered a series of reforms to cure the deficiencies leading to the crisis, including among others: the G-20, the International Monetary Fund (IMF), the Bank for International Settlements (BIS), the European Commission (EC), the United Kingdom (U.K.), and the United States (U.S.).² Notable among

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1. See, for example, the planned reorganization of the UK Financial Services Authority (UK FSA), to commence January 11, 2011 and conclude in 2012, which was part of the platform on which the new Conservative Government campaigned. The proposed changes, now underway, transfer prudential supervision back to the Bank of England (BOE). See Financial Regulatory Forum, <http://blogs.reuters.com/financial-regulatory-forum/2010/07/26/factbox-uk-fleshes-out-financial-supervisory-shake-up/> (July 26, 2010, 12:48 EDT).

2. See, e.g., G-20 Leader's Statement, The Pitt. Summit (Sept. 24–25, 2009), available at <http://www.pittsburghsummit.gov/mediacenter/129639.htm>; INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: NAVIGATING THE FINANCIAL CHALLENGES AHEAD (2009), available at <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>; see also G-20, G-20 WORKING GROUP 3: REFORM OF THE IMF: FINAL REPORT ¶¶ 18.4–18.6 (2009), available at http://www.g20.org/Documents/g20_wg3_010409.pdf; THE DE LAROSIÈRE GROUP, THE HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU (2009), available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf; THE FIN. SERVS. AUTHORITY, THE TURNER REVIEW: A REGULATORY

these proposals is that of the Financial Stability Board (FSB)—created in April 2009³ as a successor to the Financial Stability Forum (FSF)—to

RESPONSE TO THE GLOBAL BANKING CRISIS (2009), available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf; THE U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf; The White House Proposal, available at <http://documents.nytimes.com/amendments-to-the-bank-holding-company-act#document/p1>; H.R. 4173, 111th Cong. (2010), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf (the so-called Volcker Rule or modified return to the Glass-Steagall limitations on proprietary trading within deposit-taking banks); S. 3217, 111th Cong. (2010), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3217as.txt.pdf (related and now adopted legislation). Among other things, these include recommendations with respect to: (1) defining high quality capital and mitigating pro-cyclicality; (2) strengthening accounting standards; (3) reforming compensation practices; (4) improving OTC derivatives risk management; (5) addressing cross-border issues and systemically important financial institutions; and (6) strengthening adherence to international standards.

3. In a press release on progress subsequent to the G-20 London Summit, the Financial Stability Board (FSB) included the following commitment to promoting adherence to international standards: "The FSB is developing a system of peer reviews of regulatory and prudential standards and of policies agreed in the FSB." Press Release, Fin. Stability Bd., Financial Stability Board Reports on Improving Financial Regulation (Sept. 25, 2009), available at http://www.financialstabilityboard.org/press/pr_090925a.pdf. See also FIN. STABILITY BD., OVERVIEW OF PROGRESS IN IMPLEMENTING THE LONDON SUMMIT RECOMMENDATIONS FOR STRENGTHENING FINANCIAL STABILITY (2009), available at http://www.financialstabilityboard.org/publications/r_090925a.pdf; FIN. STABILITY BD., PROGRESS SINCE THE PITTSBURGH SUMMIT IN IMPLEMENTING THE G20 RECOMMENDATIONS FOR STRENGTHENING FINANCIAL STABILITY (2009) [hereinafter FSB, PROGRESS SINCE PITTSBURGH], available at http://www.financialstabilityboard.org/publications/r_091107a.pdf?noframes=1.

The FSB is comprised of representatives from twenty-four countries, six international organizations, and six international standard setters, including Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Mexico, the Netherlands, the Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, the United Kingdom, the United States of America; the Bank for International Settlements (BIS), the European Central Bank (ECB), the European Commission (EC), the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the World Bank; the Basel Committee on Banking Supervision (BCBS), the Committee on the Global Financial System (CGFS), the Committee on Payment and Settlement Systems (CPSS), the International Association of Insurance Supervisors (IAIS), the International Accounting Standards Board (IASB), and the International Organization of Securities Commissions (IOSCO). Fin. Stability Bd., Links to FSB Members, <http://www.financialstabilityboard.org/members/links.htm> (last visited Sept. 4, 2010).

In connection with this project the International Monetary Fund (IMF) and the FSB predecessor institution, the Financial Stability Forum, agreed from the outset to support G-20 recommendations in a letter dated November 13, 2008. Fin. Stability Forum & Int'l Monetary Fund, Joint Letter to the G-20 Ministers and Governors (Nov. 13, 2008), available at http://www.financialstabilityboard.org/publications/r_081113.pdf. In August 2010, citing a proposal dated August 10, 2010, the Executive Board of the IMF explicitly accepted membership in the FSB. See INT'L MONETARY FUND, IMF MEMBERSHIP IN THE FINANCIAL STABILITY BOARD ¶¶ 9, 17 (2010), available at <http://www.imf.org/external/np/pp/eng/2010/081010.pdf>; INT'L MONETARY FUND, EXECUTIVE BOARD, IMF MEMBERSHIP IN THE FINANCIAL STABILITY BOARD (2010), available at <http://www.if.org/external/np/pp/eng/2010/081010a.pdf>. More recently, upon announcing publication of a report on the *Intensity and Effectiveness of Systemically Important Financial Institution (SIFI) Supervision*, the FSB stated:

While the [SIFI] recommendations are primarily aimed at making SIFIs less susceptible

require biennial peer reviews, coupled with IMF assessments, of at least the G-20 countries for “compliance” with existing key standards and codes for regulators and supervisors—that is, more aggressive enforcement through mutual evaluations, peer pressure, and oversight reviews of the effectiveness of micro-prudential supervisory and regulatory practices.⁴

Undeniably, more alert and more stringent, enforcement of such global standards, as are currently in place, might have avoided some of the regulatory failures that led to the current crisis, described by many as the greatest since the Great Depression. Undeniably, stronger enforcement of existing requirements is a laudable goal in and of itself. The question raised by this Article is, even so, can enforcement of existing global standards for capital markets as articulated by the International Organization of Securities Commissions (IOSCO), particularly those related to cooperative information exchange,⁵ without

to failure, there are also lessons for the supervision of financial institutions more generally. The FSB has asked standard setters and national authorities to follow up on these recommendations as they incorporate them into supervisory core principles and national supervisory frameworks respectively. For several key recommendations, standard setters and national authorities have been asked to report their progress to the FSB. FSB thematic peer reviews and IMF/World Bank FSAP [Financial Stability Assessment Program] assessments will assess national implementation and ongoing conformity with these higher standards.

Press Release, Fin. Stability Bd., Financial Stability Board Releases Report on Supervisory Intensity and Effectiveness 2 (Nov. 1, 2010) (The report is available at http://www.financialstabilityboard.org/publications/r_101101.pdf). This report does not comprehensively address non-banking, securities intermediaries.

4. FIN. STABILITY BD., FSB FRAMEWORK FOR STRENGTHENING ADHERENCE TO INTERNATIONAL STANDARDS 1 (2010) [hereinafter FSB FRAMEWORK], available at http://www.financialstabilityboard.org/publications/r_100109a.pdf. Part of this document is republished in Annex I-C, *infra*. Cf. JOHN PALMER & CAROLINE CERRUTI, IS THERE A NEED TO RETHINK THE SUPERVISORY PROCESS? (2009) (prepared for an international conference organized by the World Bank and Banco de Espana).

5. The FSB also focuses on non-cooperative jurisdictions, with the possible sanction of so-called “name and shame” measures. FSB, PROGRESS SINCE PITTSBURGH, *supra* note 3, at 10. See FIN. STABILITY BD., PROMOTING GLOBAL ADHERENCE TO INTERNATIONAL COOPERATION AND INFORMATION EXCHANGE STANDARDS 20 (2010) [hereinafter FIN. STABILITY BD., PROMOTING GLOBAL ADHERENCE], available at http://www.financialstabilityboard.org/publications/r_100310.pdf; see also G-20, Declaration on Strengthening the Financial System (Apr. 2, 2009), available at http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf. If there is any doubt of the power of “grey or black listing,” one need only observe the increasing level of high level political activity directed to avoiding being on any such list that occurs when jurisdictions are warned of potential listing in connection with insufficient procedures to combat money-laundering. See, e.g., Colin Powell, Chairman, N.J. Fin. Servs. Comm’n, Address on Anti-Money Laundering (Nov. 21, 2003), http://www.jerseyfsc.org/the_commission/general_information/speeches/stepjersey.asp; see also FIN. STABILITY FORUM, REPORT OF THE WORKING GROUP ON OFFSHORE CENTERS (2000), available at http://www.financialstabilityboard.org/publications/r_0004b.pdf; Press Release, Fin. Stability Forum, FSF Reviews Offshore Financial Centres (OFCs) Initiative (Apr. 5, 2004), available at http://www.financialstabilityboard.org/press/pr_040405.pdf. The FSB will particularly concern itself

more—however valuable—be expected to prevent or remedy a future credit and confidence crisis? And, if not, what actions, such as (1) enhanced guidance on implementation, (2) addition of more quantitative measures of compliance, (3) expansion of the standards for cooperative information sharing, or (4) agreement on particular prophylactic systemic protections, would be necessary to achieve these goals?

II. BACKGROUND

A. *The IOSCO Standards*

Prior to June 2010, the securities (capital markets) standards or the Objectives and Principles of Securities Regulation (Principles), contained three objectives, thirty principles and an annex on the related laws that are preconditions to robust securities regulation.⁶ These were explained both in an initial document containing the Principles⁷ and in a later-developed Assessment Methodology document relating to their implementation.⁸ At IOSCO's Annual Meeting in Montreal in June 2010, revisions to the Principles, but not the related texts, were adopted that acknowledge certain of the points made below.⁹ More reforms are ongoing, with further reporting of these expected in April at IOSCO's

with the review of those Principles listed in Annex I-C for each financial sector.

6. INT'L ORG. OF SEC. COMM'NS, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION i-iii (2008, originally published in 1998) [hereinafter IOSCO PRINCIPLES], *available at* <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD265.pdf>; Annex I-A, *infra*. As of the first quarter of 2011, the FSAP reports on standards and codes (ROSC) continue to be conducted using the 1998 (as reissued in 2008) Principles. Where the term "Principle" is referred to in the text of this document, it refers to that Principle as constituted between 1998 and 2010. As a whole these Principles are, referred to herein as the IOSCO Principles. The new Principles adopted in 2010 are renumbered, so that the numbers that were previously used for certain Principles have been changed. Principles from 2010 will be referred to as New Principles and the Principles as a whole will be referred to as 2010 Principles. *See infra* note 9.

7. IOSCO PRINCIPLES, *supra* note 6.

8. INT'L ORG. OF SEC. COMM'NS, METHODOLOGY FOR ASSESSING IMPLEMENTATION OF THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (2008, originally published in 2003) [hereinafter IOSCO METHODOLOGY], *available at* <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD266.pdf>.

9. The updated 2010 version of the IOSCO Principles (hereinafter referred to as 2010 Principles), contains 38 Principles. The 2010 Principles effectively add nine new Principles in that former Principles 6 and 7 were consolidated. INT'L ORG. OF SEC. COMM'NS, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (2010) [hereinafter 2010 PRINCIPLES], *available at* <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>; Annex I-B, *infra*. These new Principles relate to hedge funds, credit rating agencies and other evaluators, the conflict prevention process, a process relative to systemic risk appropriate to the mandate of the regulatory authority, and a process to review the perimeter or scope of regulatory authority. 2010 PRINCIPLES, *supra*. While there is currently no agreed text explaining, or methodology for implementing, the new Principles, discussions are ongoing within several committees of IOSCO.

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2011 Annual Meeting in South Africa.

The Principles were originally adopted in September 1998 as a policy response to the Asian financial crisis and became one of the standards and codes referred to when the financial stability assessment program for assessing jurisdictions' regulatory frameworks first began.¹⁰ In 2003, after a painful multi-year joint drafting exercise, IOSCO also published an extensive Methodology for assessing implementation of the Principles¹¹ in an attempt to make the assessments more consistent and to provide more guidance on what should be deemed to constitute compliance. In 2004, an e-methodology version of the Methodology together with some additional instructions, links to relevant IOSCO reports, and a set of frequently asked questions were adopted and in 2007 these were made public to non-members.¹²

The Principles and the Methodology reflect consensus among all the national authorities representing widely different markets at different stages of market development that are members of IOSCO, an institution with over a hundred members from more than a hundred jurisdictions.¹³ As of 2007, some seventy-five financial sector assessments for the securities sector had been conducted and evaluated by the IMF and the World Bank staff and experts in accordance with the IOSCO standards.¹⁴ In addition to updates, the IMF and World Bank are now in

10. The Financial Stability Forum originally endorsed twelve Key Standards and Codes. Fin. Stability Bd., 12 Key Standards for Sound Financial Systems, http://www.financialstabilityboard.org/cos/key_standards.htm (last visited July 24, 2010). The FSB currently cites a broader compendium of standards and codes on its website. Fin. Stability Bd., Subject Area – Financial Regulation and Supervision, http://www.financialstabilityboard.org/list/fsb_cos_subject_area/tid_99/index.htm (last visited Sept. 27, 2010); Fin. Stability Bd., Subject Area – Institutional and Market Infrastructure, http://www.financialstabilityboard.org/list/fsb_cos_subject_area/tid_98/index.htm (last visited Sept. 27, 2010); Fin. Stability Bd., Subject Area – Macroeconomic Policy and Data Transparency, http://www.financialstabilityboard.org/list/fsb_cos_subject_area/tid_97/index.htm (last visited Sept. 27, 2010).

11. IOSCO METHODOLOGY, *supra* note 8.

12. IOSCO, IOSCO E-Methodology Principles, https://www.iosco.org/webmeth_pub/index.cfm (last visited Sept. 4, 2010); INT'L ORG. OF SEC. COMM'NS, FINAL COMMUNIQUÉ OF THE XXIXTH ANNUAL CONFERENCE OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (2004), <http://www.iasplus.com/resource/0405iosco.pdf> (IOSCO announcing the availability of an e-methodology in 2004). The actual methodology was not posted on the non-member portion of the IOSCO website, however, until 2007.

13. IOSCO, IOSCO Historical Background, <https://www.iosco.org/about/index.cfm?section=background> (last visited Sept. 4, 2010); IOSCO, Ordinary Members of IOSCO, https://www.iosco.org/lists/display_members.cfm (last visited Sept. 4, 2010) (listing 114 Ordinary Members).

14. See also the discussion by IMF staff relating to levels of implementation, which raises the issue of consistent ratings, especially where qualitative judgments on implementation are required. Ana Carvajal & Jennifer Elliott, *Strengths and Weaknesses in Securities Market Regulation: A Global Analysis* 10, 48 (Int'l Monetary Fund, Working Paper No. WP/07/259, 2007), available at <http://www.imf.org/external/pubs/ft/wp/2007/wp07259.pdf>. IOSCO also conducts "assisted self-

the process of completing assessments of those G-20 countries which have not yet been subject to a Financial Stability Assessment, including the United States and Indonesia (2009–2010) and China (2011) and beginning a round of more rigorous evaluations. The assessments are performed by experienced assessors,¹⁵ including those nominated by IOSCO, who possess broad knowledge of multiple markets.

The collaborative IOSCO process of standard development and elucidation is markedly different from that for development of the Basel core standards for banking supervision, which from the outset, until recently, were disseminated from the top down by the G-10 major jurisdictions and which contain certain quantitative measures of “compliance.”¹⁶ Historically, the canon of the IOSCO Principles, in recognition of the diversity among securities markets, has been that there is “often no single correct approach to a regulatory issue.”¹⁷ The Principles explicitly acknowledge that legislative “and regulatory structures vary between [and among] jurisdictions and reflect local market conditions and historical development.”¹⁸

B. What Is Missing? IOSCO Principles and Methodology Set a Sound Framework But Are Not Helpful on Certain Matters Relevant to the Crisis

The Principles describe a comprehensive framework for capital markets regulation that delineates the essential qualities and powers of a

assessments,” which are effectively mutual evaluation exercises. IOSCO, Self-Assessment for Securities Regulators: Instructions and Templates, https://www.iosco.org/webmeth_pub/Instructions.cfm (last visited Sept. 4, 2010).

15. FIN. STABILITY BD., PROMOTING GLOBAL ADHERENCE, *supra* note 5, at 8.

16. The Basel Committee on Banking Supervision (BCBS) of the Bank for International Settlements (BIS) is the standard setter for banking supervisors and author of the Basel Core Principles for Bank Supervision. The jurisdictions which currently are members of the BCBS are Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. About the Basel Committee, <http://www.bis.org/bcbs/index.htm> (last visited Feb. 9, 2011). The present Chairman of the Committee is Mr. Nout Wellink, President of the Netherlands Bank. *Id.* The BCBS was twice expanded in 2009: on March 13 Australia, Brazil, China, Korea, Mexico and Russia were added and on June 10 Argentina, Indonesia, Saudi Arabia, South Africa and Turkey were added. Press Release, Bank for Int’l Settlements, Expansion of Membership Announced by the Basel Committee (Mar. 13, 2009), <http://www.bis.org/press/p090313.htm>; Press Release, Bank for Int’l Settlements, Basel Committee Broadens Its Membership (June 10, 2009), <http://www.bis.org/press/p090610.htm>. See also BASEL COMM. ON BANKING SUPERVISION, CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (2006), available at <http://www.bis.org/publ/bcbs129.pdf>.

17. IOSCO METHODOLOGY, *supra* note 8, at 5.

18. IOSCO PRINCIPLES, *supra* note 6, at 3.

capital markets regulator;¹⁹ the elements of proper oversight of issuers, collective investments, intermediaries, and markets;²⁰ and the components of an effective enforcement regime.²¹ As such, they are intended to permit the identification of regulatory gaps and deficiencies, to expose insufficiencies in relevant laws and applicable resources, and to illustrate what makes national regulators good citizens of the international community. The Methodology provides an assessment process using Key Issues and Questions intended to result in a standardized form of rating as well as preambles and explanatory notes that provide further content to application of the Principles.

The IOSCO-related assessment exercises, to which countries formerly voluntarily submitted, have materially improved the power and independence of regulators, identified and helped to close regulatory loopholes, and prompted a worldwide race to reform financial regulation, in particular the capacity to combat cross-border misconduct.²²

In many ways, despite what is known today about new fragilities in the financial system, the Principles and the related Methodology seem remarkably prescient. However, by design and omission, the Principles have some significant lacunae, particularly in light of recent experience with respect to the products, transactions, and issues they cover. Moreover, the Principles were intended to continue to evolve, based upon regulatory experience and new information developed on markets and market misconduct, so as to remain capable of achieving their stated objectives, including protecting investors, maintaining fair, efficient, and transparent markets, and mitigating systemic risk.²³

19. *Id.* at i (Principles 1–5, which are “Principles Relating to the Regulator”).

20. *Id.* at ii–iii (Principles 14–16 (“Principles for Issuers”), 17–20 (“Principles for Collective Investment Schemes”), 21–24 (“Principles for Market Intermediaries”), 25–30 (“Principles for the Secondary Market”)).

21. *Id.* at i–ii (Principles 8–10 (“Principles for Enforcement of Securities Regulation”), 11–13 (“Principles for Cooperation in Regulation”)).

22. Carvajal & Elliott, *supra* note 14.

23. IOSCO PRINCIPLES, *supra* note 6, at 3; *see also, e.g., id.* at 1–2 (relating to the challenges of technology, globalization, cross-border conduct, interdependencies among products, intermediaries and regulators and the relationship of “high regulatory standards and effective international cooperation [to] reduce systemic risk”); *id.* at 3 (commenting on implementation that speaks of markets being “in a constant state of development” and that regulation must change “to facilitate and properly regulate [the] changing markets”); *id.* at 5–7 (discussing the inter-linkages among objectives, specifically noting that instability may result from events outside a jurisdiction or across several jurisdictions and the importance of insolvency legislation); *id.* at 8 (noting the importance of the regulatory environment and in particular the legal framework (including Bankruptcy or Insolvency law as referred to in Annex 3) or pre-conditions); *id.* at 9 (discussing the potential for inequities or gaps where a product or service exhibits characteristics associated with securities, banking and insurance); *id.* at 13 (describing SRO conflicts where an SRO handles both member and market regulation); *id.* at 21 (describing the issues

1. Apparent Gaps

In light of recent events, there are significant gaps in the Principles as they existed in 1998, for which any remedies intended by the 2010 Principles remain obscure. By their terms, the Principles do not cover certain ground. For example, although they purport to extend to derivatives markets, at least listed or regulated derivatives, the Principles' text explicitly acknowledges that derivatives, which are quintessentially global, may require additional measures.²⁴ The Principles do not cover private offers or define what a private offer of securities is.²⁵ They also treat certain issues, such as governance, anti-money laundering, and clearing and settlement, rather superficially, deferring to other codes or authorities and not elaborating much on the particular interests of securities regulators in these issues.²⁶ They do not

related to conglomerates); *id.* at 24 (addressing the importance of enforcement not just against fraud but of issuer obligations); *id.* at 25 (commenting on the reliability of financial information to informed decision making); *id.* at 36 (risks from off-balance sheet and unlicensed affiliates); *id.* at 31 (noting the difficulty of fair value asset valuation). The foregoing recitation of high level references to regulatory issues ("principles-based concerns") that remain startlingly current suggest areas where some expansions might be made to provide further guidance. The original Principles were articulated under the guidance and leadership of the three IOSCO Chairs at a Chair Committee level, however, using high level staff *sherpas*. Arguably any proposed enhancement of the Principles should receive the same level of engagement and consistency of attention at this juncture by the high level leaders of IOSCO. This may be difficult when the responsiveness of existing regulators to many specific matters is under attack in several jurisdictions.

24. Much of the current crisis response is directed to derivatives, however. As stated by the EU Commission:

The market for derivatives is global. To ensure an ambitious and convergent international regulatory outcome, the proposals are in line with the objectives agreed at the G20 meeting of 25 September 2009. The [European] Commission intends to further develop the technical details in cooperation with its G20 partners in order to ensure a coherent implementation of these policies across the globe and thus avoid regulatory arbitrage. Such cooperation is particularly important with the US, which is also in the process of designing a new approach to derivatives markets.

Press Release, European Comm'n, Financial Services: Commission Sets Out Future Actions to Strengthen the Safety of Derivatives Markets (Oct. 20, 2009), *available at* <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1546&format=HTML&language=EN>.

But see EU Hints of Different Approach to U.S. on Banks, MONEYNEWS.COM, Feb. 17, 2010, <http://moneynews.com/InvestingAnalysis/EU-Approach-U-S--Banks/2010/02/17/id/350139>

("According to a briefing note given to finance ministers and obtained by The Associated Press, European officials 'expressed their concern that the application of the Volcker rule in the EU may not be consistent with the current principles of the internal market and universal banking.'"). The Dodd-Frank legislation adopted in 2010 *does* include language drawn from the Volcker proposal, but is less restrictive than originally projected. *See, e.g.,* Editorial, *Dodd-Frank Bill's Volcker Rule a Win for Big Banks*, ATLANTIC, June 25, 2010, <http://www.theatlantic.com/business/archive/2010/06/dodd-frank-bills-volcker-rule-a-win-for-big-banks/58747/>.

25. *See* IOSCO PRINCIPLES, *supra* note 6, at ii (Principles 14–16); IOSCO METHODOLOGY, *supra* note 8, at 70–71, 76–77, 82–83 (Explanatory Notes for Principles 14–16).

26. IOSCO PRINCIPLES, *supra* note 6, at 8, 16, 48 (deferring to the Organization of Economic

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provide definitive measures for evaluating prudential requirements; and, although new work has been done on cross-border cooperation,²⁷ nor do the Principles themselves appear to provide much guidance on the use of information sharing and cooperative measures for pre-empting and managing financial disruption and crisis as opposed to after-the-fact enforcement efforts.

a. The Prudential Gap

Only four of the original Principles—22, 24, 29, and 30—are directly related to the financial integrity of markets and intermediaries and to the handling of market disruptions and firm failures from the perspective of the regulator. For example, Principle 23 speaks to internal controls of authorized intermediaries, largely looking at the responsibilities of intermediary management and less extensively at the role of the regulator. Importantly, the IOSCO Principles do not prescribe a capital or an accounting methodology other than by a caution to address all relevant risks²⁸ and to apply consistent and high level standards.²⁹ Additionally, the Principles do not take a position on the desirability of compensation arrangements (or safety nets) to cover customer funds in the event of an intermediary default or on other measures intended to prevent financial contagion or losses of confidence.³⁰ The Principles and Methodology also do not provide much detail on how best to conduct ongoing surveillance of markets to identify risk factors relevant to systemic financial disruptions as opposed to identifying misconduct such as miss-selling, manipulation, and insider trading. Guidance on how to measure regulatory performance is also quite limited.³¹

Thus, the pre-2010 Principles at the basis of the IOSCO assessment of standards and codes for capital markets arguably do not

Cooperation and Development (OECD) as the governance standard setter, the Financial Action Task Force (FATF) as the AML/anti-terrorism financing, standard setter, and the work of the Committee on Payment and Settlement Systems (CPSS) and IOSCO on clearing and settlement); IOSCO METHODOLOGY, *supra* note 8. A consultation on refining the clearing and settlement standards (principles for financial markets infrastructures—FMIs) commenced March 10, 2011.

27. See TECHNICAL COMM. OF THE INT'L ORG. ON SEC. COMM'NS, PRINCIPLES REGARDING CROSS-BORDER SUPERVISORY COOPERATION (2010), available at <http://www.iosco.org/library/publicdocumentsIOSCOPD322.pdf>.

28. IOSCO METHODOLOGY, *supra* note 8, at 104–05 (emphasis on Principle 22, Key Issue 3, and Key Questions 2 and 3).

29. *Id.* at 82–83 (Principle 16, Explanatory Note).

30. *Id.* at 128 (Principle 24, stating that such matter should be taken into consideration by assessors).

31. See Carvajal & Elliott, *supra* note 14, at 10 (discussing implementation and raising the issue of consistent ratings, especially where qualitative judgments on implementation are required).

comprehensively address the identification, measurement, and mitigation of prudential risks and other potentially systemic vulnerabilities relevant to crisis prevention and crisis management, which were at the core of the global community's current financial woes. For example:

- The amount and quality of capital;
- The ratio of short to long term financing;
- The appropriate level of regulatory scrutiny of the financial risk consequences of particular product structures or trading practices;
- The nature of liquidity and means for achieving liquidity in compromised markets;
- The use of leverage and collateral;
- The mechanisms whereby financial contagion is transmitted from the banking to the securities sector and vice versa or could spread from outside the regulated sector;³² and
- The measurement of risk.

In this regard, the IOSCO Principles could be viewed as lacking agreed views on certain elements of the regulatory framework, which could be critical to the resolution and prevention of future crises.

To some, the current crisis was a typical banking crisis deriving largely from a business model that borrows short, lends long, and relies on liquidity arrangements not segregation of client assets and money to return customer/depositor money. For them, the securities-related issues are largely secondary. Nonetheless, if one is to market enforcement of the securities core principles as a remedy for crisis, then the content of the Principles and the related Methodology for applying them should be reviewed with that objective in mind.

b. The "Outside the Perimeter"³³ Gap

Similarly, the scope of the Principles is limited. Many products and transactions are intentionally excluded, among them foreign currency, certain commodities, and bullion³⁴ as beyond the current jurisdiction of securities regulators or not subject to regulation under existing

32. Consider, for example, the cash commodity markets or unregulated, so-called "shadow-banking," markets.

33. 2010 PRINCIPLES, *supra* note 9, at 4 (New Principle 7 states that "[t]he Regulator should have or contribute to a process to review the perimeter of regulation regularly.").

34. IOSCO METHODOLOGY, *supra* note 8, at 5.

legislation although potentially within the mandate of such regulators. The Principles do not treat the particular issues of over-the-counter (OTC) derivatives, certain wholesale transactions, opaque non-regulated markets, or so-called hedge funds.³⁵ Nor do they even touch upon the potential risks and tribulations related to securitization. Further, while they *do* give assessors the capacity to make some judgments as to certain issues related to private offers, any analysis of when information asymmetry, for example, can disrupt markets as well as be a conduct of business³⁶ issue is mostly absent. Nor has much related work been done on risk migration or the various synergies for good or ill among various types of markets, including regulated and unregulated markets.

c. The Information-Sharing Gap

Principles 11–13 are related to information sharing and cooperation. Significant strides have been made in advancing the extent to which regulators assist each other (1) to prevent fraudsters from hiding beyond national borders and (2) to address insider trading and market abuse that can originate from market participants located outside the jurisdiction of the market's establishment or can migrate from the cash to the derivatives market and vice versa. With the technology revolution and growth of cross-border business, this type of assistance is increasingly essential.³⁷ Steps are now being taken to extend the international community's expectation with respect to a regulator's ability to engage

35. See TECHNICAL COMM. OF THE INT'L ORG. OF SEC. COMM'NS, THE REGULATORY ENVIRONMENT FOR HEDGE FUNDS: A SURVEY AND COMPARISON 3 (2006), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD226.pdf> (exploring whether IOSCO should take a more active role in regulating hedge funds). The 2010 Principles do address hedge funds. 2010 PRINCIPLES, *supra* note 9, at 10 (New Principle 28 states that "[r]egulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.").

36. "Conduct of business" includes such considerations as fair and equitable treatment of clients and timely delivery of material disclosures.

37. In 2007, Chicago Mercantile Exchange (CME) reported that it had 150,000 screens located outside the U.S., and brokers in listed-derivatives typically operate in multiple jurisdictions. In the U.S., 145 non-US firms operate in the U.S. through Part 30 exemptions. See, e.g., Andrea M. Corcoran, *Regulating Futures Markets, the Evolving Federalist Model*, FUTURES INDUSTRY ASS'N MAG., May/June 2007, available at <http://www.futuresindustry.org/fi-magazinesphome.asp?a=1188>; see also U.S. Commodity Futures Trading Comm'n, List of Foreign Part 30 Exemptions, <http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignPart30Exemptions> (last visited Feb. 9, 2010). The National Futures Association (NFA), the only CFTC-registered futures association, processes applications and maintains information on Part 30-qualified firms—though these processes are currently under review due to ongoing financial reform. While no aggregate number is on the public website, NFA reported when queried that 145 firms make use of this exemption which permits reliance for some purposes on foreign regulators. See 17 C.F.R. § 30.10 (2010); Andrea M. Corcoran, *Regulators: Leadership and Reaction*, in 10 ELECTRONIC EXCHANGES: THE GLOBAL TRANSFORMATION FROM PITS TO BITS 227 (Michael Gorham & Nidhi Singh eds., 2009).

in information sharing with views on its more substantive power to freeze assets and to prevent the sequestration of ill-gotten gains behind non-cooperative jurisdictional screens.³⁸

But information shared for enforcement purposes, usually after the fact of a violation or market disturbance, is not targeted to pre-empting or remediating crises. While a common bond among regulators, encouraged by the disciplined process articulated by IOSCO to become a signatory of the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMOU),³⁹ to share enforcement information has markedly reduced the ability to hide the fruits of fraud or market abuse behind borders, enforcement sharing will not necessarily prevent systemic risks or other vulnerabilities related to financial failures. Indeed, at least temporary “forbearance” of enforcement or intervention (though a disfavored regulatory methodology) is often the most pragmatic response to preventing potential contagion until the regulator or supervisor has followed any missing funds and staunched the bleeding.

International enforcement cooperation as described in the Principles—even under the IOSCO gold standard—then may not be a solution to financial crisis. New norms of cooperation other than after-the-fact sharing are now not merely desirable but critical, and more guidance is necessary. In recognition, in May of 2010, IOSCO’s Technical Committee (of basically the G-20 jurisdictions) adopted new Principles for sharing information for cross-border supervisory purposes, including a related memorandum of understanding or MOU template.⁴⁰ The IOSCO Principles, however, extend to all IOSCO jurisdictions. To address the need for preventive information sharing, one can expect

38. TECHNICAL COMM. OF IOSCO, AN OVERVIEW OF THE WORK OF THE IOSCO TECHNICAL COMMITTEE (2007) (“In addressing cross-border fraud, IOSCO has recognised (in its 7 June 2006 Resolution on Cross-border Cooperation to Freeze Assets Derived from Securities and Derivatives Violations) that the effective enforcement of securities laws and regulations would increase if national regulators can provide cross-border assistance to a regulator in another jurisdiction in freezing assets relating to securities violations. At this time, not all IOSCO jurisdictions have sufficient powers to freeze assets which have derived from fraudulent activities. Therefore, IOSCO has encouraged its members to examine the legal framework under which they operate and strive to develop mechanisms by which within their jurisdiction these assets could be frozen.”).

39. INT’L ORG. OF SEC. COMM’NS, MULTILATERAL MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION AND COOPERATION AND THE EXCHANGE OF INFORMATION (2002) [hereinafter *IOSCO MMOU*], available at www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf. IOSCO requires applicants to become signatories to pass a screening process and has a monitoring committee that monitors ongoing compliance. See IOSCO, List of Signatories, www.iosco.org/library/index.cfm?section=mou_siglist (last visited Feb. 27, 2011) (current signature list).

40. See TECHNICAL COMM. OF THE INT’L ORG. ON SEC. COMM’NS, *supra* note 27.

increasing interest in, and calls for, the IOSCO-wide Principles to *require* so-called “second-generation” (or on-going) information sharing understandings designed (1) to detect and deter particular risks proactively and (2) to better measure risks across borders.

Some jurisdictions have already implemented such arrangements.⁴¹ For example, the listed derivatives markets’ regulators have been leaders in developing, through a number of international meetings in the 1990’s, some consensus on the types of information that should be shared to assure appropriate forward-thinking surveillance of markets for prudential failures as well as market abuses. These separate initiatives have in the past led to detailed work within IOSCO, although these initiatives are not used in standards assessments.⁴² The broader

41. As an example, see the U.S. Commodity Futures Trading Commission (CFTC) arrangements with the U.K. Financial Services Authority (UK FSA). U.S. Commodity Futures Trading Comm’n, Memoranda of Understanding, <http://www.cftc.gov/International/MemorandaofUnderstanding/index.htm> (last visited July 31, 2010) (noting memorandum of understanding between the CFTC and the UK FSA); *see also* Press Release, U.S. Commodity Futures Trading Comm’n, U.S. Commodity Futures Trading Commission and the U.K. Financial Services Authority Sign an MOU to Address Cross-Border Market Surveillance Concerns (Nov. 20, 2006), *available at* <http://www.cftc.gov/PressRoom/PressReleases/pr5259-06.html> (commenting on surveillance sharing). The UK FSA will cede prudential oversight and take on an enhanced oversight of conduct role commencing in 2011 through 2012. These changes may result in concomitant changes in existing information sharing arrangements. Such adjustments were made previously when the Financial Services Authority succeeded the Securities Investment Board, one of its predecessor agencies.

42. TECHNICAL COMM. OF THE INT’L ORG. OF SEC. COMM’NS, THE APPLICATION OF THE TOKYO COMMUNIQUÉ TO EXCHANGE-TRADED FINANCIAL DERIVATIVES CONTRACTS (1998) [hereinafter APPLICATION OF THE TOKYO COMMUNIQUÉ], *available at* <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD85.pdf>. That report states:

In October 1997, regulatory authorities from 16 jurisdictions responsible for supervising commodity futures markets participated in the Tokyo Commodity Futures Markets Regulators’ Conference in Tokyo, Japan At the end of the meeting the regulators issued the Tokyo Communiqué on Supervision of Commodity Futures Markets which, among other things, endorsed two guidance papers relating to exchange-traded derivatives: (1) Guidance on Standards of Best Practice for the Design and/or Review of Commodity Contracts (‘Design Guidance’); and (2) Guidance on Components of Market Surveillance and Information Sharing (‘Surveillance Guidance’) (collectively ‘the Tokyo Guidances’).

APPLICATION OF THE TOKYO COMMUNIQUÉ, *supra*, at 2.

For example, the Tokyo Communiqué specifically states:

[I]n view of the fact that information is a critical tool for maintaining fair and orderly markets and ensuring market integrity in non-financial physical delivery markets with finite supply, . . . market authorities should seek the removal of domestic legal or other barriers to ensure, consistent with the regulatory framework of each jurisdiction, access by market authorities to information that permits them to detect and to deter abusive practices and disorderly conditions in the markets, including access to information that permits them to identify concentrations of positions and the overall composition of the market.

TOKYO COMMODITY FUTURES MARKETS REGULATORS’ CONFERENCE (THE TOKYO COMMUNIQUÉ) 9

relevance of this work is not spelled out in the existing Assessment Methodology nor is it part of the IOSCO vetting process related to information sharing. Among other things, these initiatives addressed issues relative to the design of derivative contracts to assure that they have economic as well as speculative value and real-time ways to assess ongoing risks in markets where mutualization of risk through central counterparties is the typical means of assuring performance and settling accounts. These initiatives, which address systemic concerns, could be revisited in the context of equity and over-the-counter markets now in the context of deepening the usefulness of the IOSCO Principles.

2. Proactive Information Sharing, While Helpful, May Not Be Enough

No matter how good the information sharing regime is, there remains suspicion among regulators as a group that when there is a problem that threatens the health of a national institution, the national regulator addresses its own exposures first before it calls its regulatory counterparts.⁴³ Politicians do not receive many plaudits for saving their neighbors' citizens from loss, although in light of the increasing integration of the financial community, perhaps they should.

Consequently, even though enhanced cooperation and proactive information sharing is desirable, and may provide a better understanding of interconnected risks and the size of market problems or the deficiencies in national data, such information sharing may not, in and of itself, be enough to address market failures where insufficient funds to satisfy outstanding claims are at stake.

If :

- there is no assurance that any domestic insolvency regime will provide equivalent protection to all similarly situated market participants (e.g., with the same class of claim);
- there is an insufficiency of funds to cover all claims;
- an early actor can adversely affect a fair allocation of losses;

(1997), available at <http://www.meti.go.jp/policy/commerce/intl/tkyc.pdf>. See also TECHNICAL COMM. OF IOSCO, GUIDANCE ON INFORMATION SHARING (1997) [hereinafter TECH. COMM., GUIDANCE], available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD86.pdf>.

43. Anecdotal, in the case of the Société Générale rogue trader, M. Kerviel, some jurisdictions claimed that the French authorities addressed any potential domestic exposures without informing their international regulatory confreres until the problem was past. In the case of the Barings collapse, anecdotal, all futures positions at the then London Financial Futures Exchange (LIFFE) were transferred before the BOE took up the phone to call American regulatory authorities. Cf. Andrea M. Corcoran, *Markets' Self-Assessment and Improvement of Default Strategies after the Collapse of Barings*, 2 STAN. J.L. BUS. & FIN. 265 (1996). See also Will Acworth, *The Lessons of Lehman, Reassessing Customer Protections*, FUTURES INDUSTRY, Jan.-Feb. 2009, available at <http://www.futuresindustry.org/fi-magazine-home.asp?a=1297>.

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or

- the ability to prevent contagion by moving funds with positions does not exist;

then: all the enforcement of existing standards, cooperation, and information sharing in the world will not remedy the difficulty.

3. The Moving Target

The IOSCO Principles were originally written in 1998. The Methodology was originally published in 2003. To date, the means of updating these has been to provide footnotes relating to IOSCO reports that give more content to the high level Principles and that can be consulted by assessors.⁴⁴ Not all of these reports, however, have been adopted by the full IOSCO. Further, to date, there has been no specific agreement on when needed guidance ought to be explicitly included in the Principles or the Methodology. Nor is there any guidance on how to use the existing footnotes. The new Principles announced in 2010 have yet to be explicated, though work is ongoing, and do not cover all of the issues identified here.

4. Capital Markets Issues and the G-20

In a February 2009 press release, after the G-20's Washington Summit, IOSCO's Secretary General indicated that IOSCO recognized the need to update its program as part of its policy response to the crisis. He relates how IOSCO was an active participant in identifying new areas of concentration, stating: "In recognition of its role in the development of international regulatory standards, IOSCO has also been invited to participate in two of the G-20 Working Groups—Enhancing Sound Regulation and Strengthening Transparency; and Financial Market Integrity and International Cooperation."⁴⁵ He noted that IOSCO itself had convened three specialist Task Forces to look at: short

44. IOSCO PRINCIPLES, *supra* note 6, at 2 ("Many of the topics addressed in this document are already the subject of IOSCO reports or Resolutions. The reports published by IOSCO and the Resolutions adopted by its membership are also a valuable source of information on the principles that underlie effective securities regulation and the tools and techniques necessary to give effect to those principles. This document draws upon those reports as a primary source. IOSCO's reports generally provide a more detailed treatment of the particular topic. Reference is made to those reports and resolutions in the notes to this document and they should be consulted when considering particular topics. Full copies of the text of reports and resolutions can be obtained from the IOSCO Secretariat."). In 2003 and most recently in 2008 the notes referring to other reports in the Principles and the Assessment Methodology were updated.

45. Greg Tanzer, Int'l Org. of Sec. Comm'ns, *Increased Co-operation is Essential: IOSCO's Response to the G-20 Challenge to Financial Regulators*, HEDGE FUND JOURNAL, Feb. 2009.

selling; unregulated entities, and unregulated markets and products.⁴⁶ He concluded that, IOSCO believed that: its “participation in [the G-20] Working Groups will ensure that the views of securities regulators are present at the policy formulation stage within the G-20.”⁴⁷ In light of the complications of securitization and various securities markets products, it is not only beneficial but vital for IOSCO to be a full participant in the ongoing standards dialogue.

However, there is no corresponding statement yet as to how this work is projected to be integrated in the existing Methodology.

5. Altering the Canon of Country Specificity

Placing increased reliance on the effectiveness of the execution of the Principles may put pressure on the former canon within the IOSCO community that some differences in regulatory tools, techniques, and the execution of regulatory mandates may be necessary because of differences in the nature of the assessed markets’ level of development and in the applicable legal system (common law, civil, *etc.*). No real attention beyond the Methodology has been given to how much flexibility can be tolerated in interpreting the Principles if they are to result in public ratings that are comparable across jurisdictions or in equivalent conditions of cross-border competition.

IOSCO’s rating system sets a compliance bar that jurisdictions must meet. Moving to a stronger view, as has been done with the IOSCO MMOU, on where consistency is essential will require strength of will and a better appreciation of precisely where equivalence or convergence as opposed to harmonization is desired. Determining under which circumstances jurisdictional differences in approach are not acceptable may be quite difficult especially where discretion and flexibility remain necessary to meet market evolutions and allocations of resources.

Nonetheless, as outlined in another context, in order for standards to work properly and not be gamed or permit unfair competition related to the costs of capital, some measures may need to be common or commonly understood and interpreted, even if for others, exemptions,

46. *Id.* See, e.g., TECHNICAL COMM. OF THE INT’L ORG. OF SEC. COMM’NS, REGULATION OF SHORT SELLING (2009), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf>; TECHNICAL COMM. OF THE INT’L ORG. OF SEC. COMM’NS, HEDGE FUNDS OVERSIGHT (2009), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf>; TECHNICAL COMM. OF THE INT’L ORG. OF SEC. COMM’NS, UNREGULATED FINANCIAL MARKETS AND PRODUCTS (2009), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf>; BASEL COMM. ON BANKING SUPERVISION, REPORT ON SPECIAL PURPOSE ENTITIES (2009), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD308.pdf>.

47. Tanzer, *supra* note 45.

substituted compliance, information sharing, and additional transparency or disclosure⁴⁸ may suffice. For example, international coordination and cooperation intended to address fair and equitable sharing of losses or treatment of failing institutions undertaking cross-border business ultimately may require more convergence to achieve their objectives than those of better disclosure.

Common understandings of the numbers produced by capital requirements and accounting also may require more prescription than discretion.⁴⁹ If capital models and measures are idiosyncratic or disbelieved by the industry or the public, if the data on which they are based is incomplete or broadly different, or if the data that they produce is suspect, these seeming flaws could engender inter-jurisdictional mistrust. In turn mistrust can adversely affect inter-jurisdictional cooperation and resolution arrangements as well as mutual clearing commitments or insurance regimes. Quantitative cross-border misunderstandings can result in distrust of the efficacy of information sharing as a mechanism for managing financial or market disruptions and can prevent or delay regulatory expectations concerning the practicability of work out or rescue arrangements, such as the transfer of accounts from failing to solvent institutions. Lack of common understandings can also call into question the veracity of statements of financial condition⁵⁰ upon which investment, disinvestment, and

48. Consider the very interesting common comment responding to the Committee of European Securities Regulators (CESR) call for evidence submitted by the EU-US Coalition, including among others the Futures and Options Association (FOA), the Futures Industry Association (FIA) and the Securities Industry and Financial Markets Association (SIFMA). Response by the EU-US Coalition on Financial Regulation to the CESR Call for Evidence on Mutual Recognition of Non-EU Jurisdictions (Sept. 2009) [hereinafter Response], available at <http://europe.sifma.org/docs/CommentLetters/20090916FOA,SIFMA,LIBA,ABASA,BAFT,BBA,FIA,ICMA,IIAC,ISDA,SBA,EBFResponseToCESRCEonMutualRecognition.pdf>. CESR, since January 1, 2011 has been superseded by the European Securities Market Authority (ESMA), an authority of the EU. Even though “politics” could take mutuality discussions off the table for the time being, the discussion in this Article regarding different means of cooperation along a continuum from increased transparency of the rules and requirements to complete equivalence or standardization should prompt at least an exercise in mapping whether there is a difference in how different Principles should be approached.

49. Even before the Lehman Repo 105 use of derivatives to change the look of their financial condition across a reporting period, such “window dressing,” or “false reporting,” as the case may be was observed in other contexts and jurisdictions. See Andrew Clark, *Lehman Brothers: Repo 105 and Other Accounting Tricks*, GUARDIAN (U.K.), Mar. 12, 2010, available at <http://www.guardian.co.uk/business/2010/mar/12/lehman-brothers-repo-105-enron> (discussing how other companies have used techniques similar to those used by Lehman Brothers).

50. See, e.g., Daniel Gros, *Transparency on Banks' Balance Sheets?*, CTR. FOR EUROPEAN POL'Y STUDIES, Feb. 12, 2009, available at <http://www.ceps.eu/book/transparency-banks-balance-sheets>; Daniel Gros & Cinzia Alcidi, *What Lessons from the 1930's?*, CTR. FOR EUROPEAN POL'Y STUDIES, Mar. 7, 2009, available at <http://www.ceps.eu/book/what-lessons-1930s>; Felix Roth, *Who Can be Trusted After the Financial Crisis?*, CTR. FOR EUROPEAN POL'Y STUDIES, Nov. 5, 2009, available at <http://www.ceps.eu/book/who-can-be-trusted-after-financial-crisis>; see also 2010 PRINCIPLES, *supra*

resolution as well as other regulatory decisions are based.

The most disciplined treatment of the common enforcement of standards at the “granular” level by a peer review process is the current process for accession to the IOSCO MMOU. The prescribed internal procedure includes vetting by a screening committee, an application comment process, an appeal from refusals, and an ongoing group procedure for monitoring continuing compliance.⁵¹ As of 2010, IOSCO requires all Member jurisdictions to either become a full signatory of the MMOU (e.g., an adherent listed in Annex A) or to commit to meet its terms by seeking necessary legislative change (that is, an adherent listed in Annex B). All members must accede to Annex A by 2013.⁵² The admirable process applied to MMOU screenings could be emulated in determining how best to impose more robust requirements on compliance with other core Principles. The MMOU enlists every IOSCO member in the community of regulators devoted to clean markets and fair treatment of customers to meet its stringent criteria.⁵³

III. THE WAY FORWARD: SUBSTANCE

A. More or Enhanced Guidance on Applying the Principles

In light of the high level nature of the Principles themselves and the projected expanded role for their enforcement, some gaps or ambiguities could potentially be remedied and newly pertinent issues could be addressed, through amendment of the Assessment Methodology or the production of additional guidance?⁵⁴ For example, IOSCO could

note 9 (principles 19 to 23 on auditing, credit rating agencies and evaluators); MICHAEL LEWIS, *THE BIG SHORT* (2010); BETHANY MCLEAN & JOE NOCERA, *ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS* (2010).

51. Press Release, Int’l Org. of Sec. Comm’ns, IOSCO Completes Framework to Fight Cross-Border Market Abuse (Jan. 22, 2010), *available at* <http://www.iosco.org/news/pdf/IOSCONEWS176.pdf>; Press Release, Int’l Org. of Sec. Comm’ns, IOSCO Strengthens International Cooperation to Fight Illegal Securities and Derivatives Activities (Oct. 16, 2003), *available at* <http://www.fsa.go.jp/inter/ios/20031016/01.pdf>.

52. As of July 31, 2010, there were seventy-one signatories to the IOSCO Multilateral Memorandum of Understanding. *See* IOSCO, IOSCO Library Section, www.iosco.org/library/index.cfm?section=mou_siglist (last visited Sept. 4, 2010). For the Memorandum of Understanding, *see* INT’L ORG. OF SEC. COMM’NS, *MULTILATERAL MEMORANDUM OF UNDERSTANDING: CONCERNING CONSULTATION AND COOPERATION AND THE EXCHANGE OF INFORMATION* (2002), *available at* <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf>.

53. The IOSCO MMOU requirement to commit to delivery of enforcement assistance to other member signatories is subject only to certain national public policy concerns. Information should be shared without the need for the violation for which the requesting authority seeks information to breach the requested authority’s laws. *See, e.g.,* IOSCO MMOU, *supra* note 39, § 7(c).

54. This does not appear that likely at the moment as the assessment exercise with heightened focus on compliance with the existing standards has already commenced and there will be a high level

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consider:

- covering newly perceived risks, exposures, gaps, and a spectrum of reasonable regulatory responses within existing or new explanatory notes;
- adding separate guidance to assessors on systemic vulnerabilities and risk factors that should be covered by securities regulators under each Principle as relevant;
- providing more specific guidance on implementation—such as what types of evidence to ask for, or measurement activities to undertake to assess the adequacy of capital requirements or the robustness of ongoing supervision of regulated entities;
- developing specific quantitative and qualitative tests for capital or tests of performance for accounting principles;
- providing examples, taken from assessors or participating jurisdictions, of specific fact situations where evaluation is particularly complex, such as independence, resourcing, accountability, the scope and coverage of supervisory activities, and how these relate to crisis management and resolution;
- providing examples of how financial malfeasance and improper disclosure can affect not only customer protection but also firm financial integrity and ultimately economic stability;
- adding enhancements related to preconditions, the components of the essential legal framework or environment essential to assuring the reliability of the performance of the standards (previously reputedly rejected by the IOSCO Implementation Task Force (ITF), the group drafting the Methodology, as too controversial at the national level because of limitations on the scope of regulatory authority in these areas);
- adding guidance on the nature of accountability firms and their management and directors should have for compliance; and
- taking comments from the IOSCO membership and the public as to what enhancements would have improved their jurisdictions' crisis experiences or how their regulatory experience has affected policy development.

B. Making Cooperation More Effective

As a matter of substance, post-crisis, all existing cooperative mechanisms developed by national regulators to address a crisis that infects institutions and systems beyond its national borders could be under scrutiny to determine if they are sufficiently broad and targeted

of political interest in the comparability of the assessments in view of the expectations for these, though new guidance on the revised principles is likely to be issued for consultation in April 2011. *See also* Carvajal and Elliott, *supra* at note 14.

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and the Principles (perhaps the new systemic Principle)⁵⁵ should encourage this process. These include:

- *transparency*: do current transparency requirements permit sufficiently timely means to record, aggregate, and manage cross-border and domestic exposures; are all exposures included; and are the rules of the game in the event of distress situations equivalent between insiders and outsiders and known in advance to the players;
- *information sharing*: do memoranda of understanding, colleges of regulators, dialogues, and exchange of specified information among regulators to supervise institutions exposed to and in multiple jurisdictions provide sufficiently timely and useful access to the information necessary to deliver on the comprehensive supervision promise; are they effective in practice in deterring as well as sanctioning conduct; and
- *reliance on due diligence and oversight processes of the licensing jurisdiction*: do vetting regimes and sharing of relevant capital measures and compliance provide sufficient coverage to avoid financial pandemics, credit gridlock, and serial malfeasors, or do national jurisdictions need in-country financial support for the obligations the regulator incurs to support depositors and to oversee proper regulatory compliance.

Is now not a time for IOSCO also to further address the following questions?

- Why, when, and how can one regulator rely on another regulator or risk assessment provider?
- How can we achieve international consistency of national laws where consistency is important to systemic safety?
- How can we achieve international consistency of national laws where national individuality and accountability remain important to adequate oversight, customer protection, and education?
- Having spotted the issue of interconnectedness, how can we better equip national regulators to identify and to address controlling connection risks while still serving their domestic customers?
- In that banking and capital markets are risk-connected, other

55. 2010 PRINCIPLES, *supra* note 9, at 4 (New Principle 6 states that “[t]he Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.”).

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than merely indicating that where banking and securities authorities oversee the same entity securities regulators must have a mechanism for exchanging relevant information with banking supervisors on the supervision of that entity,⁵⁶ how can we set up practical means for more broadly cooperating across sectors?⁵⁷

- Having produced specific guidance on the elements of information sharing for surveillance in some areas, how can we draw heightened attention to or revise the IOSCO Information Sharing Guidance, the Boca Declaration, or other such second generation arrangements to address market evolution?⁵⁸

56. IOSCO METHODOLOGY, *supra* note 8, at 11–12 (discussing Principle 1).

57. In this respect, note the various proposals to avoid pro-cyclicality that call for reserving capital in good times and disbursing it in bad. *See supra* note 2 and accompanying text.

58. *See* TOKYO COMMODITY FUTURES MARKETS REGULATORS' CONFERENCE (THE TOKYO COMMUNIQUÉ) (1997), available at <http://www.meti.go.jp/policy/commerce/intl/tkyc.pdf>; Fin. Stability Bd., Guidance on Information Sharing, http://www.financialstabilityboard.org/cos/cos_980301b.htm (last visited Sept. 4, 2010); U.S. Commodity Futures Trading Comm'n, Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organisations (Boca Declaration) (1998), http://www.cftc.gov/International/InternationalInitiatives/oia_bocadec0398.html (last visited Sept. 27, 2010) [hereinafter Boca Declaration]; *see also* TECH COMM., GUIDANCE, *supra* note 42. The following types of information are cited by the Boca Declaration:

1.8. An Authority may make a Request if, within the ordinary course of its existing supervisory responsibilities, it becomes aware that any of the following events has occurred with respect to a Member of a Party:

- A. A large decrease in Owner's Equity in any six month period.
- B. A Member's cumulative net Variation Payments over ten consecutive business days for proprietary and non-customer positions which are unusually large in relation to the Member's Owner's Equity.
- C. A Member's cumulative net Variation Payments over six consecutive months for proprietary and non-customer positions are unusually large in relation to the Member's Owner's Equity.
- D. A Member's net Variation Payments for customer positions for one business day which are of unusually large size in relation to the Member's Owner's Equity.
- E. Total positions in a contract registered in a Member's name, which represent at least 50% of the total long or short positions in that contract, the Open Interest of which is greater than 25,000 but less than 100,000.
- F. Total positions in a contract registered in a Member's name which represent at least 25% of the total long or short positions in that contract, the Open Interest of which exceeds 100,000.
- G. A Member, Affiliate or a firm or other person with a substantial commercial relationship to the Member experiences an event that is not listed but in the opinion of an Authority is of a similar magnitude, and the Authority determines that it has reasonable grounds to seek information in accordance with Article 3 of this Declaration.

1.9. In addition, an Authority may make a Request if: (A) there are unusually large price movements in a market under its jurisdiction and/or unusual price relationships in related

*C. Identifying Where More Guidance, Information Sharing, and
Cooperation Are Not Enough*

Placing increased reliance on these standards as mechanisms of crisis prevention materially raises the stakes on the specific manner in which the standards are met by each national authority and on how implementation by each IOSCO member is rated. Such reliance challenges the expectation that observance by IOSCO member jurisdictions of the standards as written can help protect against financial or market disruptions in ways that: (1) promote rather than discourage open markets; (2) limit unnecessary barriers to cross-border transacting; and (3) favor consistent, fair interpretation of rules for global as well as national stakeholders. Failure to make the Principles work more effectively to deliver financial stability and safety of customer funds from non-trading related failures could compromise these other beneficial goals and further atomize rather than draw together the regulatory community.⁵⁹

To the extent it is inherent for national jurisdictions to save themselves before saving others the incentives behind such conduct should be recognized. Additionally, there should be discussion of the need for automatic or prophylactic ways to deal with those risks unlikely to be mitigated by information sharing and cooperation. Ultimately, if solutions to financial crises are to cross jurisdictional boundaries effectively, more prescriptive commonalities, such as common approaches to defaults, may need to be sought.

These could include seeking broader understanding on:

- margin or leverage limits;
- position or exposure limits;
- use of collateral;
- appropriate and inappropriate ring-fencing;

markets, or (B) it has a reasonable basis to believe that a Member, also subject to the jurisdiction of another Authority, or such Member's customer or counterparty, may be attempting to accumulate an unusually large position which may have a substantial impact on the price of a contract or may be engaging in abusive activity.

Boca Declaration, *supra*.

59. For example, John Kay refers to the projected tax-payer referendum in Iceland on March 6. Icelandic banks had a branch and a subsidiary in the U.K. These banks aggressively raised deposits from U.K. retail investors. Kay states: "The only satisfactory means of dealing with these problems requires that banks match their deposits with safe assets ring-fenced within the jurisdiction in which the deposits are collected. The proposition that better regulation in all 27 member states will in [the] future prevent cross-border failures of retail banks is risible." John Kay, *Shameful Bullying Should Find Its Nemesis in Iceland*, FIN. TIMES (U.K.), Feb. 24, 2010, available at <http://www.ft.com/cms/s/0/e69c686a-20e4-11df-b920-00144feab49a.html>. The Icelandic public ultimately voted not to take responsibility for the losses to U.K. investors held by the branch; the U.K. filled the gap.

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- when insolvency⁶⁰ should be declared;
- early warnings;
- automatic expansions of collateral upon pre-set moves in the market;
- circuit breakers; and
- firm structure and the business model, *etc.*

IV. THE WAY FORWARD: PROCESS

A. Measuring the Principles Against the Crisis

So assuming that to remain credible some level of enhancement remains essential, how might IOSCO take the Principles to the next step?

Preliminarily, a gap analysis should be performed to measure the Principles against the crisis. What Principles were implicated? How did the Principles fare in addressing these? Such an analysis might expose, for example, that:

- National authorities trying to contain the contagion found that not rescuing a regulated intermediary awarded a government license to hold customer funds, absent mechanisms to keep solvent customer's deposits whole and to wind down, in an orderly manner, the intermediary where such deposits were held was not a realistic option. *Why?* Such action destabilized confidence in regulated entities more generally and precipitated runs on deposits and redemptions of collective investment fund interests.⁶¹ Panicked monetizing

60. Cf. Ross P. Buckley, *The Bankruptcy of Nations: An Idea Whose Time Has Come*, 43 INT'L LAW 1189 (2009).

61. Rarely in the midst of a crisis is letting depositors bear losses an attractive option or a desirable policy outcome. For examples, review the following: (1) Although Sweden had no deposit insurance program, it guaranteed the obligations of all banks, including deposits in 1992 in the midst of its banking crisis. Peter Englund, *The Swedish Banking Crisis: Roots and Consequences*, 15 OXFORD REV. ECON. POL'Y 80, 91-92 (1999), available at <http://www.contrahour.com/contrahour/files/TheSwedishBankingCrisisRootsandConsequences.pdf>. (2) For the U.K.'s announcement with respect to insuring U.K. depositors in the branch of a failing Icelandic bank, see Press Release, HM Treasury, Statement by the Chancellor on Financial Stability (Oct. 8, 2008), http://www.hm-treasury.gov.uk/statement_chx_081008.htm. (3) In May 1984, the U.S. insured all deposits, notwithstanding deposit limits, in Continental of Illinois, a bank with largely commercial depositors and the 7th largest bank with \$45 billion in assets. See AN EXAMINATION OF THE BANKING CRISES OF THE 1980'S AND EARLY 1990'S: CONTINENTAL OF ILLINOIS AND 'TOO BIG TO FAIL' 2 (1997), available at www.fdic.gov/bank/historical/history/235_258.pdf. More recently in the midst of the 2007-2009 crisis, the Federal Reserve on October 21, 2008 granted a loan of \$540 billion to support money market mutual funds, following an earlier smaller guarantee announced by the U.S. Treasury on September 19. The media pointed out the vulnerability of the mutual funds to redemptions. See Craig Torres & Christopher Condon, *Fed to Provide up to \$540 Billion to Aid Money Funds*, BLOOMBERG, Oct. 21, 2008, available

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of assets by the investing public in turn caused a broadening and deepening of the downward spiral as products were converted to cash, which in turn accelerated and exacerbated leveraged institutions' losses and need to roll over credit arrangements. Principles 24 and 29 require contingency plans but little guidance is given as to what these should contain. The CPSS/IOSCO standards require that customer funds not be treated as funds of the broker. There is no guidance on insolvency or compensation funds.

- Users of cross-border markets found that their funds were not retrievable in the manner, time, and amounts expected. *Why?* Administration and insolvency schemes were widely divergent and no globally-respected, market-oriented plan for promptly addressing the return of positions and funds of investors was in place. The Principles do not deal with use of collateral and cross-border retrieval of funds even conceptually.
- Brokers and investment bankers were surprised at the extent to which certain interconnected risks were opaque or could expand exponentially. *Why?* Many did not seem to understand fully how synthetic and risk transfer products such as credit default swaps products, had binary risks, and could multiply leverage effects or how two-way derivatives markets assure losers for every winner. The Principles do not address over-the-counter exposures, nor do they address risk measurement or transparency of all instruments.
- Market participants found that they did not know where their collateral was and that they did not understand the risks of the products they had purchased. *Why?* Some customers had had their collateral re-hypothecated to support or offset dealers' proprietary trading. Some customers understandably substituted the views of presumed independent professional ratings agencies for their own, less informed due diligence. The Principles address proper disclosure but not all products for which disclosure is desirable are within the ambit of

at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ajw94.nC0a5w&refer=home> (money market funds were previously explicitly uninsured). (4) For Ireland's reaction to the current crisis of guaranteeing all bank deposits, see Press Release, Ireland Dep't of Fin., Government Increases Deposit Guarantee to Euro 100,000 per Depositor (Sept. 20, 2008), available at <http://www.finance.gov.ie/viewdoc.asp?DocID=5466>. As the EU Directive provided for 20,000 Euros, it was rumored that this announcement caused deposits to move to Ireland provoking a debate within the European Union as to the appropriateness of allowing the level of deposit insurance to be a minimum as opposed to a maximum harmonization directive.

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capital markets regulators disclosure requirements.⁶²

- Some U.S. proponents of consolidation of the financial services industry and its regulators abruptly reversed direction. *Why?* Because some saw insuperable conflicts within single institutions; because some feared firms were not only too big to fail, but also too big to manage or too powerful to regulate. And, because some, perhaps inadvertently, promoted policies that would deny governmental support and attention to non-systemically significant institutions thereby potentially fostering further consolidation. The Principles do not address firm structure or market structure or complexity.
- Proponents of a national retreat from gradually moving toward a more unified international market in financial services emerged, as did the dread words “protectionism” and “nationalism.”⁶³ Rhetoric was flung around, such as “banks have no social utility,” or particular jurisdictions are “train wrecks.” *Why?* This type of regulatory nationalism is a risk of a belief that any international regulatory regime/philosophy is incapable of addressing all the specific risks that are political threats to national authorities and nations. After all, taxpayers and fiscal policies are national not international.

This gap analysis underscores the risk of relying totally on compliance with standards, information exchange, and cooperation to address issues related to burden sharing as to which the Principles offer no guidance.

B. Developing a Road Map Toward a Solution

Having identified gaps and deficiencies the rest of the process is to examine what might be the various mechanisms for their remediation. To this end, the following process is proposed:

First, there should be a mapping exercise to determine where

62. The 2010 PRINCIPLES, *supra* note 9, do address Credit Rating Agencies at new Principles 22 and 23. New Principle 22 now reads: “Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.” *Id.* at 9. New Principle 23 reads: “Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.” *Id.*

63. Response, *supra* note 48, § 2.6 (“In its Communication, ‘Driving European Recovery’ (4th March 2009), the European Commission emphasized that ‘protectionism and a retreat towards national markets could only lead to stagnation, a deeper and longer recession and lost prosperity’ (page 11) and that ‘an unequivocal message is essential to hold off these threats’ (i.e. ‘domestic pressure to apply restrictive measures’)”).

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effective cooperation and prevention of market and firm disruption can be maximized by transparency, comparability, equivalence, and reliance.

Second, existing measures for combating contagion from an unhealthy to a healthy institution should be surveyed, for example: the Windsor Declaration,⁶⁴ the Boca Declaration (with specific information exchange points), and the Tokyo Communiqué, *supra*; various regimes for protection of customer assets, including segregation, insurance or other compensation schemes; liquidity facilities, including ad hoc facilities; market protective insolvency regimes, including provision for portability of accounts; and certain private sector systems for better understanding cumulative risks, such as the old Chicago Mercantile Exchange (SAFE) system that aggregated data on exposures including margin surpluses and deficits across markets and compared information on trends and differences in excess of specified tolerances on a daily, weekly, monthly, bi-yearly, and yearly basis.

Third, determine what, if any, incentives/best practices are, or should be, in place for regulated entities to protect themselves from financial loss or mispricing risks due to incomplete information, such as through trader mis-recording or late confirmation of trades.

Fourth, review existing IOSCO guidance on information necessary to address firm and market disruptions, especially with relation to large market moves, and update that guidance based on a review of the various existing surveillance regimes for market disruption across markets.

Fifth, develop a library of case studies on vulnerabilities experienced in various jurisdictions and the policy responses thereto.

Sixth, develop more guidance on implementation of the Principles, including any additional principles intended to address the issues not currently covered, with examples.

Seventh, share information with other sectoral regulators, including banking, insurance, pensions, and compensation schemes, on IOSCO's results.

Eighth, conduct crisis scenario exercises, including cross-sectoral scenario exercises, to expose unexpected vulnerabilities, including technological vulnerabilities.

Ninth, further cultivate informal networking among regulators and standard setters but expand this to cross-sectoral (banking, insurance, securities, and any other non-banking financial institutions) networking.

Tenth, develop an internal review or appellate process for debating and resolving issues related to key Principle compliance.

64. This is attached as Annex II.

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An action plan along the foregoing lines should move the process within IOSCO toward meeting the promise that the Principles were to be an evolving, living framework that responds to changes in the environment. It would also help to assure that compliance with international standards buttresses regulatory, national and international resilience to meet ongoing and future financial stresses and strains.

Some of these issues are already firmly on the table, but more progress could be made.⁶⁵

V. CONCLUSION

Despite improvement in the markets and the economy, the markets remain fragile and repairing the financial system remains an urgent priority. The financial services industry is a major employer and, when held properly accountable to the public, an engine of economic wealth.

And a lot is at stake.

It is important that planned remedial actions do not delude us into thinking an unsolved problem is solved. Cooperation alone cannot succeed without recognition of the public policy interests of national jurisdictions and strong national enforcement of the requirements relating to individual institutions and jurisdictions. Cooperation cannot succeed where institutions distrust available information, suspect that needed information exchange will not occur in a timely fashion,⁶⁶ or where there are insufficient assets to satisfy all creditors and so-called burden-sharing among jurisdictions and stakeholders is unavoidable. Cooperation without more will not resolve the issue of disputed claims to the same capital, inconsistent measurements of risk and liquidity, inter-related exposures that are opaque, or the design of contracts that take advantage of junior lenders, have unvalued optionality, or cause perverse incentives.

Many of the standards, not just the IOSCO standards, as they stand may not really speak to these types of vulnerabilities in a comprehensive

65. TECHNICAL COMM. OF THE INT'L ORG. ON SEC. COMM'NS, MITIGATING SYSTEMIC RISK: A ROLE FOR SECURITIES REGULATORS (2011), *available at* <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD347.pdf>.

66. The CFTC Part 30 exemption required requesting foreign broker dealers to be sponsored by a regulatory (or private regulatory) authority, consent to jurisdiction in the U.S., limits direct operations, trade in only non-U.S. derivatives, certify (and have their sponsoring jurisdiction certify) that they would not be barred from recognition in the U.S. by U.S. statutory disqualification or fitness standards, provide for dispute resolution arrangements that are convenient for U.S. customers, assure the proper treatment of customer funds, and provide disclosure that the operative regulatory requirements might not be identical to those in the U.S. 17 C.F.R. § 30, App. A (2010). Such arrangements, in place since 1989, should be models for increasing the efficiency and effectiveness of oversight of entities where cross-border transacting is permitted.

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way. Efforts should be made to more clearly identify and address, or indicate where there is no intention to address, these limitations. If great expectations for the standards are maintained by the political community and these are disappointed in fact by regulators, the consequences are unlikely to be good. These known in advance limitations could prevent broader needed reform or taint other clearly worthwhile cooperative initiatives, such as access and other arrangements that depend on cooperative information sharing.⁶⁷ It would be a pity if the consequence of potential failures due to the known limits of cooperative measures might cause needed, operating cooperative measures to address cross-border activities by entities supervised by non-national supervisors or their customers to be eschewed. It would be unfortunate indeed if a failure to enhance or to define the limits of the Principles, caused the proposed remedies for this crisis to be perceived as the generator of the next.

67. The EU Passport, the CFTC Part 30 regime, and various recognitions regimes, in jurisdictions as dispersed as Australia and Canada, acknowledge that a regulator may have superior access to information (capital, probity) about its own nationals than the regulator of another jurisdiction in which that national seeks to engage in cross-border operations, and concomitantly that the jurisdictions that grants access may have superior information about business done in that jurisdiction than the national regulator. The National Futures Association (a self-regulatory authority with quasi-governmental status) operates a system which automatically pushes out information on changes in regulatory status of firms that are licensed here that have been admitted into other jurisdictions based on their U.S. license. See Nat'l Futures Ass'n, Who We Are, <http://www.nfa.futures.org/NFA-about-nfa/index.HTML> (last visited July 31, 2010). Currently ten jurisdictions take advantage of this system.

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Annex I-A: IOSCO Principles as of 1998⁶⁸

A. Principles Relating to the Regulator

1 The responsibilities of the regulator should be clear and objectively stated.

2 The regulator should be operationally independent and accountable in the exercise of its functions and powers.

3 The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

4 The regulator should adopt clear and consistent regulatory processes.

5 The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.

B. Principles for Self-Regulation

6 The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets.

7 SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

C. Principles for the Enforcement of Securities Regulation

8 The regulator should have comprehensive inspection, investigation and surveillance powers.

9 The regulator should have comprehensive enforcement powers.

10 The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

68. The following material is copied from IOSCO PRINCIPLES, *supra* note 6, at i–iii.

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D. Principles for Cooperation in Regulation

11 The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

12 Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.

13 The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

E. Principles for Issuers

14 There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions.

15 Holders of securities in a company should be treated in a fair and equitable manner.

16 Accounting and auditing standards should be of a high and internationally acceptable quality.

F. Principles for Collective Investment Schemes

17 The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.

18 The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.

19 Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.

20 Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a

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collective investment scheme.

G. Principles for Market Intermediaries

21 Regulation should provide for minimum entry standards for market Intermediaries.

22 There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

23 Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.

24 There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.

H. Principles for the Secondary Market

25 The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.

26 There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.

27 Regulation should promote transparency of trading.

28 Regulation should be designed to detect and deter manipulation and other unfair trading practices.

29 Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

30 Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

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Annex I-B: IOSCO Principles as of June 2010⁶⁹

A. Principles Relating to the Regulator

1 The responsibilities of the Regulator should be clear and objectively stated.

2 The Regulator should be operationally independent and accountable in the exercise of its functions and powers.

3 The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

4 The Regulator should adopt clear and consistent regulatory processes.

5 The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.

6 *The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.*

7 *The Regulator should have or contribute to a process to review the perimeter of regulation regularly.*

8 *The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.*

B. Principles for Self-Regulation

9 *Where the regulatory system [regime should] makes [appropriate] use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, [to the extent appropriate to the size and complexity of the markets] such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.*⁷⁰

69. The following material is copied from 2010 PRINCIPLES, *supra* note 9, at 4–12. Italics represent additions to the 1998 text, and brackets represent deletions.

70. New Principle 9 combines former Principles 6 and 7. See 2010 PRINCIPLES, *supra* note 9, at 5. Former Principle 6 read: “The regulatory regime should make appropriate use of Self-Regulatory

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C. Principles for the Enforcement of Securities Regulation

10 The Regulator should have comprehensive inspection, investigation and surveillance powers.

11 The Regulator should have comprehensive enforcement powers.

12 The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

D. Principles for Cooperation in Regulation

13 The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

14 Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.

15 The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

E. Principles for Issuers

16 There should be full, accurate and timely disclosure of financial results, *risk* and other information *which* [that] is material to investors' decisions.

17 Holders of securities in a company should be treated in a fair and equitable manner.

18 Accounting [and auditing] standards *used by issuers to prepare financial statements* should be of a high and internationally acceptable quality.

Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets." IOSCO PRINCIPLES, *supra* note 6, at i.

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F. Principles for Auditors, Credit Ratings Agencies, and other information service providers

19 *Auditors should be subject to adequate levels of oversight.*

20 *Auditors should be independent of the issuing entity that they audit.*

21 *Audit standards should be of a high and internationally acceptable quality.*

22 *Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.*

23 *Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.*

G. Principles for Collective Investment Schemes

24 *The regulatory system should set standards for the eligibility, [and the regulation] governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.*

25 *The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.*

26 *Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.*

27 *Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.*

28 *Regulation should ensure that [there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a*

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collective investment scheme] *hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.*

H. Principles for Market Intermediaries

29 Regulation should provide for minimum entry standards for market intermediaries.

30 There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

31 Market intermediaries should be required to [comply] *establish an internal function that delivers compliance* with standards for internal organization and operational conduct, [that] *with the aim [to] of protecting* the interests of clients *and their assets and ensuring* proper management of risk, [and under] *through* which management of the intermediary accepts primary responsibility for these matters.

32 There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.

I. Principles for Secondary Markets

33 The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.

34 There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.

35 Regulation should promote transparency of trading.

36 Regulation should be designed to detect and deter manipulation and other unfair trading practices.

37 Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

38 [Systems for clearing and settlement of securities] *Securities*

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settlement systems and central counterparties should be subject to regulatory [oversight, and] *and supervisory requirements that are* designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

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Annex I-C: FSB Cooperation Standards List⁷¹**Regulatory and supervisory standards concerning international cooperation and information exchange**

There are three key standards in the financial regulatory and supervisory area: the Basel Core Principles for Effective Banking Supervision, the IAIS Insurance Core Principles, and the IOSCO Objectives and Principles of Securities Regulation. The FSB in consultation with the BCBS, IAIS and IOSCO identified, within each of these standards, principles concerning international cooperation and information exchange. This built on earlier work by the Financial Stability Forum to identify a list of standards for priority implementation.

The principles listed below were selected based on two criteria: principles that relate directly to cooperation and information exchange, and principles that relate to essential supervisory powers and practices, without which effective cooperation and information exchange cannot take place. While the issues covered by some of the principles listed below are broader than cooperation and information exchange, these principles are the most relevant to the focus of the FSB. Principles that solely or mainly concern cooperation and information exchange in the areas of tax, anti-money laundering or combating the financing of terrorism were excluded because adherence to these is evaluated by other international bodies, notably the OECD and FATF.

Core Principles for Effective Banking Supervision (BCBS)*Licensing and Structure*

3. Licensing criteria: The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

71. The following material is copied from FSB FRAMEWORK, *supra* note 4, at 6–8 (internal citations and footnotes omitted).

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Methods of Ongoing Banking Supervision

21. Supervisory reporting: Supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.

Consolidated and cross-border banking supervision

24. Consolidated supervision: An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.

25. Home-host relationships: Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.

Insurance Core Principles and Methodology (IAIS)

The supervisory system

5. Supervisory cooperation and information sharing: The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.

The supervised entity

6. Licensing: An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.

7. Suitability of persons: The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.

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Ongoing supervision

17. Group-wide supervision: The supervisory authority supervises its insurers on a solo and a group-wide basis.

Objectives and Principles of Securities Regulation (IOSCO)

B. Principles for the Enforcement of Securities Regulation

8. The regulator should have comprehensive inspection, investigation and surveillance powers.

9. The regulator should have comprehensive enforcement powers.

10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

D. Principles for Co-operation in Regulation

11. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.

13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

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Annex II: Windsor Declaration⁷²

Representatives of Regulatory Bodies from 16 Countries Responsible for Supervising the Activities of the World's Major Futures and Options Markets (collectively, the "Authorities") met on 16 and 17 May 1995 at Windsor in the United Kingdom and determined to Issue the Windsor Declaration.

...

THE AUTHORITIES reviewed recent developments in, and discussed the regulatory implications of, the increasing volume of cross-border transactions on international futures and options exchanges increasingly linked by common members and participants and similar products.

THE AUTHORITIES took note of previous work on international regulatory co-operation and exchanged views on specific co-operative measures to strengthen regulatory supervision, minimise systemic risk and enhance customer protection with a view to preventing or containing the adverse effects of financial disruptions. In particular, they addressed issues related to:

- Co-operation between market authorities
- Protection of customer positions, funds and assets
- Default procedures
- Regulatory co-operation in emergencies

THE AUTHORITIES noted that these are issues of importance to all futures and options exchanges, and clearing houses (collectively, "markets") in consequence of which:

I. THE AUTHORITIES REACHED THE FOLLOWING POINTS OF CONSENSUS

That increasingly, members of one market or companies materially associated with such members, trade for themselves or customers in multiple jurisdictions. Mechanisms should be in place to ensure that enhanced co-operation and communications occurs as necessary

72. The following material is copied from U.S. Commodity Futures Trading Comm., International Initiatives: Windsor Declaration, http://www.cftc.gov/International/InternationalInitiatives/oia_windsordeclaration.html (last visited Dec. 6, 2010) (internal footnotes omitted).

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between regulators and/or market authorities to minimise the adverse consequences of market disruptions caused by defaults or other failures. This is because an individual regulator or market authority alone may not have information on all material exposures of market members, financial intermediaries and any materially associated companies. ACCORDINGLY, the Authorities will support, subject to appropriate confidentiality protections, mechanisms to improve prompt communication of information relevant to material exposures and other regulatory concerns.

That protection of customer positions, funds and assets carried by financial intermediaries plays an important role in customer protection and the reduction of the potential for systemic risk. ACCORDINGLY, the Authorities will review the adequacy of existing arrangements to minimise the risk of loss through insolvency or misappropriation and enhance such arrangements as appropriate.

That effective exchange and clearing house default procedures coupled with other regulatory measures, such as effective margining systems, can mitigate the risk of losses arising from the inability of solvent participants to close out or manage their exposures to a failing market member and the consequent potential for systemic failure. ACCORDINGLY, the Authorities, cognisant of national insolvency regimes, will promote as appropriate national provisions and market procedures that facilitate the prompt liquidation and/or transfer of positions, funds and assets, from failing members of futures exchanges.

That recent market developments require effective international co-ordination and timely communication of reliable information which is essential for supervisory purposes when a financial intermediary, a market member, or a market experiences material financial or operational difficulties. ACCORDINGLY, the Authorities will support measures to enhance emergency procedures at financial intermediaries, market members and markets and to improve existing mechanisms for international co-operation and communication among market authorities and regulators.

II. THE AUTHORITIES AGREED TO PROMOTE

- Active surveillance within each jurisdiction of large exposures by market authorities and/or regulators as appropriate.
- Development of mechanisms to ensure that customer

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positions, funds and assets can be separately identified and held safe to the maximum extent possible and in accordance with national law.

- Enhanced disclosure by the markets of the different types and levels of protection of customer funds and assets which may prevail, particularly when they are transferred to different jurisdictions, including through omnibus accounts.
- Record-keeping systems at exchanges and clearing houses and/or market members which ensure that positions, funds and assets to be treated as belonging to customers can be satisfactorily distinguished from other positions, funds and assets.
- Enhanced disclosure by markets to participants of the rules and procedures governing what constitutes a default and the treatment of positions, funds and assets of member firms and their clients in the event of such a default.
- The immediate designation by each regulator of a contact point for receiving information or providing other assistance to other regulators and/or market authorities and the means to assure twenty-four hour availability of contact personnel in the event of disruption occurring at a financial intermediary, market member or market.
- Review of existing lists and assuring maintenance by IOSCO of an international regulatory contracts list.
- The development by financial intermediaries, market members or markets and regulatory authorities of contingency arrangements, or a review of the adequacy of existing arrangements, and enhancement as appropriate.

III. THE AUTHORITIES RECOMMENDED THAT FURTHER WORK SHOULD BE UNDERTAKEN IN THE APPROPRIATE INTERNATIONAL BODIES TO CONSIDER

1. With respect to co-operation between market authorities:

A survey of current procedures for identifying large exposures in individual markets;

The type of information which may assist regulators and markets to evaluate the exposure of market members, financial intermediaries and any materially associated companies;

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The circumstances, including triggers or thresholds, for obtaining such information;

Mechanisms whereby large exposure and other relevant information is and could be shared on a bilateral or multilateral basis among regulators and markets;

Arrangements to ensure confidentiality and that such information is used solely for the regulatory purpose for which it was provided; and

Arrangements to strengthen the regulatory oversight of financial groups operating internationally.

2. With respect to protection of customer positions, funds and assets:

The current types and levels of protection in different jurisdictions with respect to customer funds and assets; how best to facilitate better and more consistent protection among jurisdictions; and how best to assure continued protection when funds and assets are transferred to another intermediary or jurisdiction or held in a bank affiliated with the intermediary;

The development of best practices with regard to: the treatment of customer positions, funds and assets and how they are distinguished from intermediary's own positions, funds and assets, including when held in omnibus accounts, with a view to maximising the safety of those funds and assets; and

The development of best practices with regard to risk management for the protection of the intermediary.

3. With respect to default procedures:

The development of best practices by market authorities with regard to the treatment of positions and funds in the event of a financial disruption at a member firm so as to permit the prompt isolation of the problem at the failing firm;

The development of best practices with regard to the handling of customer positions, funds and assets held in omnibus accounts at markets in the event of a default;

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The development of standards for information to be made available to customers as to the default and assessment procedures of markets;

The establishment of means whereby information can efficiently and effectively be communicated by the relevant market authorities to market participants in the event that default procedures are implemented; and

The types of arrangements that might apply in the event that the position to be liquidated by a market is of a size that threatens the stability of the market.

4. With respect to regulatory co-operation in emergencies:

The development of best practices for control and management of a significant business disruption by financial intermediaries, market members and markets.

The Chairman of the Technical Committee of IOSCO and the Secretary General of IOSCO, who attended the Windsor meeting, endorsed the proposal to take matters forward promptly under the auspices of IOSCO, in close consultation with the markets and market authorities.

The Authorities Further Agreed That the work identified above should begin immediately through the Technical Committee of IOSCO. The Chairmen of the Securities Investments Board and Commodity Futures Trading Commission have been invited to report interim progress at the next meeting of the Technical Committee in Paris on 9 and 10 July.

ANNEX I LIST OF AUTHORITIES ATTENDING WINDSOR MEETING

Australia

Australian Securities Commission

Brazil

Comissão de Valores Mobiliários

Canada

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Commission des Valeurs Mobilières du Québec
Ontario Securities Commission

France

Commission des Opérations de Bourse

Germany

Bundesaufsichtsamt für den Wertpapierhandel

Hong Kong

Securities and Futures Commission

Italy

Commissione Nazionale per le Società e la Borsa

Japan

Securities Bureau of the Ministry of Finance

Netherlands

Securities Board of the Netherlands

Singapore

The Monetary Authority of Singapore

South Africa

Financial Services Board

Spain

Comisión Nacional del Mercado de Valores

Sweden

Swedish Financial Supervisory Authority

Switzerland

The Federal Banking Commission

United States of America

Commodity Futures Trading Commission
Securities and Exchange Commission

United Kingdom

Securities and Investments Board

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ANNEX II

Particular note was taken of the following reports produced by IOSCO's Technical Committee:

- Principals for the Supervision of Financial Conglomerates (October 1992).
- Mechanisms to Enhance Open and Timely Communication between Market Authorities of Related Cash and Derivative Markets during Periods of Market Disruption (October 1993).
- Operational and Financial Risk Management Control Mechanisms for the Over the Counter Derivatives Activities of Regulated Securities Firms (July 1994).
- Framework for Supervisory Information about the Derivatives Activities of Banks and Securities Firms (Joint Paper with the Basle Committee of Banking Supervision (May 1995)).